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May 27, 2003

VIA Facsimile: (202) 622-4804

Ms. Tara P. Volungis
Office of the Associate Chief Counsel
Internal Revenue Service
CCPSI: Branch 3, Room No. 5016
1111 Constitution Ave., NW
Washington, D.C. 20224

Re: 26 Code of Federal Regulations Section 301.6112-1

Dear Ms. Volungis:

We are writing to comment on the above-referenced regulation relating to the requirement to prepare, maintain, and furnish lists with respect to potentially abusive tax shelters (the "**Regulations**"). These comments are provided on behalf of the Corporations Committee (the "**Committee**") of the Business Law Section of the State Bar of California (the "**Business Law Section**"). Please note that positions set forth in this letter are only those of the Committee. As such, they have not been adopted by either the State Bar's Board of Governors, its overall membership, or the overall membership of the Business Law Section, and are not to be construed as representing the position of the State Bar of California. The Committee is composed of attorneys regularly advising California corporations and out-of-state corporations transacting business in California. **Membership in the Business Law Section, and on the Committee, is voluntary and funding for activities of them, including all legislative activities, is obtained entirely from voluntary sources. There are currently more than 9,500 members of the Business Law Section.**

This letter addresses issues arising under Regulations that we have identified as having specific conflicts with California law and the obligations of attorneys practicing in California. We recognize that prior to the adoption of the Regulations, the Internal Revenue Service ("**IRS**") had issued temporary and proposed regulations. We also recognize that the Department of the Treasury and the IRS received numerous comments on the proposed regulations and that the final Regulations were revised to tailor more narrowly the scope of the transactions for which disclosure and maintenance of information is required. However, we believe that it is important

to draw your attention to the conflicts between the professional obligations of California lawyers and the requirements under the Regulations.

In particular, we are recommending that the Regulations be amended to expressly authorize attorneys to withhold the following:

- Communications covered by the attorney-client privilege;
- Work covered by the work product doctrine; and
- Confidential information of their clients.

I. DISCUSSION

A. BACKGROUND.

Under the Regulations, a "participant" in a "reportable transaction" must disclose the transaction on Form 8886 which is to be filed with the participant's tax return. We believe that the category of "reportable transactions" is quite broad and includes non-abusive corporate and other business transactions that are commonly encountered by California lawyers. Under the regulations, there are six categories of "reportable transactions" (in each case as defined and subject to various exceptions):

- Confidential transactions;
- Loss transactions;
- Transactions with a significant book-tax difference;
- Transactions with a brief asset holding period;
- Transactions with contractual protection; and
- Listed transactions.

In general, the Regulations apply to "organizers and sellers" of a transaction that is a "potentially abusive tax shelter". Under the regulations, a person is an organizer of, or a seller of, an interest in a transaction if that person is a "material advisor" with respect to the transaction. A person is a material advisor with respect to a transaction if, among other things, the person receives, or expects to receive, a "minimum fee" and makes a "tax statement" to or for the benefit of five categories of persons. The minimum fee is $50,000, except where all participants in the transaction are corporations, in which case the minimum fee is $250,000. Because the minimum fee includes all fees for advice in connection with the transaction, we expect that many corporate transactions will exceed the applicable threshold. In addition, we believe that many merger and

other corporate transactions will involve participants who are natural persons and stockholders. This will have the effect of lowering the threshold to $50,000. A "tax statement" is any statement, oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a "reportable transaction" or a "tax shelter" as defined. We believe that in many routine corporate transactions, attorneys are likely to provide tax statements in the course of negotiating and documenting a transaction.

The regulations require a material advisor, including an attorney, to prepare, maintain and disclose a list that includes, among other things: a description of the transaction; the name and address of specified persons to whom (or for whose benefit) the material advisor makes or provides a tax statement; and copies of written materials, including tax analyses or opinions, relating to the transaction that are material to an understanding of the purported tax treatment[1] or tax structure[2] that the material advisor has shown to any person (or their representatives) who acquired an interest in the transaction ("**Tax Analyses**"). The material advisor must maintain the list for seven years.

Upon the written request of the IRS, a material advisor must furnish the list to the IRS within 20 days from the day on which the list is provided. The Regulations provide that if an attorney has a reasonable belief that information is protected by the attorney-client privilege, the attorney must nevertheless maintain the list.[3] If the IRS requests the list, the material advisor may assert the attorney-client privilege *as to the Tax Analyses only* by submitting a statement signed under penalty of perjury.[4] The statement must, among other things, specifically represent both of the following with respect to each document for which the privilege is claimed:

- The information was a confidential practitioner-client communication; and

[1] The regulations define "tax treatment" to mean "the purported or claimed Federal tax treatment of the transaction". Section 301.6112-1(d)(8).

[2] The Regulations define "tax structure" quite broadly to be "any fact that may be relevant to understanding the purported or claimed Federal tax treatment of the transaction". Section 301.6112-1(d)(9).

[3] The Regulations also address claims of privilege by a material advisor who is a federally authorized tax practitioner within the meaning of 26 U.S.C. § 7525 which was enacted on July 22, 1998. We do not address the application of the attorney-client privilege or attorney work product doctrine to federally authorized tax practitioners.

[4] The Regulations provide that the material advisor may assert a privilege claim "as to the information specified in paragraph (e)(3)(i)(I)". That paragraph provides:

> Copies of any additional written materials, including tax analyses or opinions, relating to each transaction that are material to an understanding of the purported tax treatment or tax structure of the transaction that have been shown or provided to any person who acquired or may acquire an interest in the transactions, or to their representatives, tax advisors, or agents, by the material advisor or any related party or agent of the material advisor. However, a material advisor is not required to retain earlier drafts of a document provided the material advisor retains a copy of the final document (or, if there is no final document, the most recent draft of the document) and the final document (or most recent draft) contains all the information in the earlier drafts of such document that is material to an understanding of the purported tax treatment or the tax structure of the transaction . . . .

- To the best of the attorney's knowledge and belief, the attorney and all others in possession of the omitted information did not disclose the omitted information to any person whose receipt of the information would result in a waiver of the privilege.

The statement must identify and describe the nature of each document that is not produced that will allow the IRS to determine the applicability of the privilege claimed without revealing the information itself.

B. THE REGULATIONS DO NOT PROVIDE FOR THE ASSERTION OF THE PRIVILEGE WITH RESPECT TO ALL COMMUNICATIONS BETWEEN CLIENT AND ATTORNEY PRIVILEGED UNDER CALIFORNIA LAW.

As noted above, the Regulations provide a specific procedure by which an attorney may assert the attorney-client privilege with respect to the Tax Analyses. However, the Regulations do not provide for the assertion of the attorney-client privilege with respect to all communications between client and attorney that are privileged under California law.[5]

Pursuant to California Evidence Code Section 954, a client has a privilege to refuse to disclose, and to prevent another from disclosing, a confidential communication between the client and lawyer. A "confidential communication between client and lawyer" is defined as:

> [I]nformation transmitted between a client and his or her lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third persons other than those who are present to further the interest of the client in the consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship.

Cal. Evid. Code § 952. In California, the privilege applies "not only to communications made in anticipation of litigation, but also to legal advice when no litigation is threatened." *Roberts v. City of Palmdale,* 5 Cal. 4th 363, 371 (1993). The privilege, however, may be waived by voluntary disclosure to a third party. Cal. Evid. Code § 912(a). Consent includes the failure to claim the privilege in any proceeding in which the holder has the legal standing and opportunity to claim the privilege. *Id.*[6]

It is clear that attorney-client privileged communications under California law encompass more than an attorney's opinions, such as Tax Analyses (*i.e.*, those items enumerated in Section

[5] In the explanation and summary, the Department of the Treasury and the IRS stated that the reference to Section 301.6112-1(e)(3)(i)(I) reflects their belief that the other information covered by the Regulations is not privileged. For the reasons set forth in this letter, we believe that the attorney-client privilege could encompass more than the matters described in Section 301.6112-1(e)(3)(i)(I).

[6] We do not comment on the scope of the attorney-client privilege under federal law.

301.6112-1(e)(3)(i)(I) of the Regulations).[7] Accordingly, we believe that it is important to expand the Regulations to permit the claim of privilege as to all matters that are the subject of California's attorney-client privilege. Failure to do so could effectively eliminate the protection of attorney-client communications (including the Tax Analyses) in all other contexts by requiring a waiver through disclosure. Accordingly, we believe that the Regulations should be amended to permit attorneys to assert the attorney-client privilege as to all communications between client and attorney that are privileged under California law.

Courts have repeatedly recognized that the attorney-client privilege advances important public interests. *See City and County of San Francisco v. Superior Ct.* 37 Cal. 2d 227, 235 (1951) ("The privilege is given on grounds of public policy in the belief that the benefits derived therefrom justify the risk that unjust decisions may sometimes result…".); *Mitchell v. Superior Ct.* 37 Cal. 3d 591,599 (1984) ("The attorney-client privilege has been a hallmark of Anglo-American jurisprudence for almost 400 years."); and *In re Complex Asbestos Litigation*, 232 Cal. App. 3d 572, 586 (1991) ("Preserving confidentiality of communications between attorney and client is fundamental to our legal system."). Without the protection of the attorney-client privilege, clients would be inhibited from making full disclosure to legal counsel. Without free and full communication, clients will be deprived of the ability to obtain informed legal advice. We further believe that informed attorneys will be in a better position to counsel their clients against entering into abusive tax arrangements.

C. THE REGULATIONS DO NOT PROVIDE FOR THE ASSERTION OF THE WORK PRODUCT DOCTRINE BY ATTORNEYS.

The State of California has codified the attorney work product doctrine in Code of Civil Procedure Section 2018. While some matters may be protected by both the attorney-client privilege and the attorney work product doctrine, it is important to note that the work product doctrine can encompass matters that are not covered by the attorney-client privilege. In particular, the work product doctrine protects an attorney's work regardless of whether a client communicated the work to the attorney or the attorney communicated the work to the client.[8] Under California's statute, any writing that reflects an attorney's impressions, conclusions, opinions, or legal research or theories is not discoverable under any circumstances. Cal. Civ. Proc. Code § 2018(c). *See State Comp. Ins. Fund v. Superior Ct.*, 91 Cal. App. 4th 1080 (2001).

The work product doctrine represents the public policy of California to: (i) preserve the rights of attorneys to prepare cases for trial with that degree of privacy necessary to encourage them to prepare their cases thoroughly and to investigate not only the favorable but the unfavorable

[7] For example, the Tax Analyses described in Section 301.6112-1(e)(3)(i)(I) does include information communicated by a client to the attorney. To fall within the ambit of that section, the material must be shown or provided *to* certain enumerated persons *by* the material advisor. In contrast, the attorney-client privilege covers communications *to* the attorney *by* the client. In addition, materials are covered by Section 301.6112-1(e)(3)(i)(I) only if they are material to an understanding of the purported tax treatment or tax structure. Again, the attorney-client privilege is not so limited.

[8] As discussed above, Section 301.6112-1(e)(3)(i)(I) is limited to materials provided *to* certain enumerated persons *by* the attorney.

aspects of those cases; and (ii) to prevent attorneys from taking undue advantage of their adversary's industry and efforts. Cal. Civ. Proc. Code § 2018(a).[9]

We note that the Regulations do not contemplate the assertion of the attorney-work product doctrine as to any class of information. Because the work-product doctrine serves important public interests, we recommend that the Regulations be amended to permit attorneys to assert the protections of the work-product doctrine.

D. THE REGULATIONS CONFLICT WITH CALIFORNIA ATTORNEYS' STATUTORY OBLIGATIONS TO PROTECT A CLIENT'S CONFIDENCES.

Members of the California bar owe an independent duty to their clients to maintain their confidences. This obligation is independent of the attorney-client privilege and the attorney work product doctrine. California attorneys are subject to the Rules of Professional Conduct of the State Bar of California, adopted by the State Bar's Board of Governors and approved by the California Supreme Court, and the State Bar Act, Cal. Business & Professions Code Section 6000 *et seq*. The duty of California attorneys with respect to client confidences is set forth in Section 6068 of the California Business and Professions Code which provides:

> It is the duty of an attorney to do all of the following: [...] (e) To maintain inviolate the confidence and at every peril to himself or herself to preserve the secrets, of his or her client.

Section 6068(e)'s admonition to counsel to maintain "at every peril to himself or herself" the confidences of counsel's client encapsulates California's tradition of strictly and zealously protecting the attorney-client privilege. As observed by our Supreme Court, "[w]hile it is perhaps somewhat of a hyperbole to refer to the attorney-client privilege as 'sacred,' it is clearly one which our judicial system has carefully safeguarded with only a few specific exceptions." *Mitchell v. Superior Ct.,* 37 Cal. 3d 591, 600 (1984) (footnote omitted). In California, the privilege extends even to prohibiting a trial court from examining documents *in camera* to determine whether the privilege adheres to the document. Cal. Evid. Code § 915; *Southern Cal. Gas Co. v. Public Utilities Comm'n,* 50 Cal. 3d 31, 45 n. 19 (1990).

That the prohibition on revealing client confidences is strictly observed was confirmed by our Supreme Court in *General Dynamics Corp. v. Superior Ct.*, 7 Cal. 4th 1164 (1994). At issue in that case was whether an in-house counsel could sue his employer for wrongful termination. Counsel alleged that the termination violated an implied contract, and that he was terminated for reasons which violated fundamental public policies. Our Supreme Court concluded that counsel could sue for breach of an implied contract, and could, to the same extent as any other non-attorney employee, sue on the grounds that his termination violated fundamental public policies, as long as, by his action, counsel did not disclose client confidences, other than as strictly permitted by the Rules of Professional Conduct or statute:

[9] While we do not address the federal work product doctrine, we do note that the United States Supreme Court has established the doctrine. *Hickman v. Taylor,* 329 U.S. 495 (1947). *See also* Rule 23(b)(3) of the Federal Rules of Civil Procedure.

> [T]he in-house attorney who publicly exposes the client's secrets will usually find no sanctuary in the courts. Except in those rare instances when disclosure is explicitly permitted or mandated by an ethics code provision or statute, it is never the business of the lawyer to disclose publicly the secrets of the client.

Id. at 1190.

Further evidence of the narrow construction given to a claimed exemption from the requirement to maintain client confidences is found in *Solin v. O'Melveny & Myers, LLP*, 89 Cal. App. 4th 451 (2001). Even more recently, California Governor Gray Davis confirmed the importance in California of the duty of counsel to maintain client confidences by his veto of AB 363, a bill that passed the California Legislature on August 28, 2002. That bill would have amended the Business and Professions Code to permit attorneys representing governmental organizations to report improper governmental activity to the "law enforcement agency charged with responsibility over the matter or to any other governmental agency or official charged with overseeing or regulating the matter..." if certain conditions were satisfied. By his veto message dated September 30, 2002, the Governor stated:

> While this bill is well intended, it chips away at the attorney-client relationship which is intended to foster candor between an attorney and client. It is critical that clients know that they can disclose in confidence so they can receive appropriate advice from counsel. The effective operation of our legal system depends on the fundamental duty of confidentiality owed by lawyers to their clients.

In light of California's unyielding requirement that attorneys maintain their clients' confidences, we believe that the Regulations should permit attorneys to refuse to produce confidential information of their clients. Unless an exception is made, California attorneys will be faced with an irreconcilable conflict between their professional responsibilities to their clients and their obligations under the Regulations.

We hope the foregoing is useful to you in considering amendments to the Regulations. Please do not hesitate to contact either of the undersigned if you have any questions on the matters raised herein.

/s/	/s/
Keith Paul Bishop Co-Chair	Bruce Dravis Co-Chair

cc: See Distribution List

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